

MINUTES

MONTANA HOUSE OF REPRESENTATIVES 57th LEGISLATURE - REGULAR SESSION COMMITTEE ON TAXATION

Call to Order: By **CHAIRMAN BOB STORY**, on February 13, 2001 at 8:00 A.M., in Room 472 Capitol.

ROLL CALL

Members Present:

Rep. Bob Story, Chairman (R)
Rep. Ron Erickson, Vice Chairman (D)
Rep. Roger Somerville, Vice Chairman (R)
Rep. Joan Andersen (R)
Rep. Keith Bales (R)
Rep. Joe Balyeat (R)
Rep. Gary Branae (D)
Rep. Eileen Carney (D)
Rep. Larry Cyr (D)
Rep. Rick Dale (R)
Rep. Ronald Devlin (R)
Rep. John Esp (R)
Rep. Gary Forrester (D)
Rep. Daniel Fuchs (R)
Rep. Verdell Jackson (R)
Rep. Jesse Laslovich (D)
Rep. Butch Waddill (R)
Rep. Karl Waitschies (R)
Rep. David Wanzenried (D)

Members Excused: Rep. Trudi Schmidt (D)

Members Absent: None.

Staff Present: Jeff Martin, Legislative Branch
Rhonda Van Meter, Committee Secretary

Please Note: These are summary minutes. Testimony and discussion are paraphrased and condensed.

Committee Business Summary:

Hearing(s) & Date(s) Posted: SB 240, 2/8/2001; SB 133,
2/8/2001
Executive Action: SB 133; HB 143; HB 247

HEARING ON SB 240

Sponsor: SENATOR WALTER McNUTT, SD 50, Sidney

Proponents: Bob Fisher, Montana Petroleum Association
Wes Welch, Encore & Montana Petroleum Association
Gloria Paladech, Richland Economic Development
Steve Snezek, Governor's Office
Stan Kaleczyc, Burlington Resources
Patrick Montalban, Northern Montana Oil & Gas
Association
Jerome Anderson, Encore Acquisitions
Gail Abercrombie, Montana Petroleum Association

Opponents: None

Opening Statement by Sponsor:

{Tape : 1; Side : A; Approx. Time Counter : 1.3}

SEN. McNUTT said the purpose of the bill is to eliminate the sunset date that granted some tax relief for secondary oil production. If this had not been done, probably a majority of the wells would have been capped. Since then about \$120 million has been spent in Eastern Montana to improve production from these wells, and if the sunset is eliminated, it is anticipated another \$40 million will be spent next year in that area.

Proponents' Testimony:

{Tape : 1; Side : A; Approx. Time Counter : 3}

Jerome Anderson, Encore Acquisitions Company, said the production in the Cedar Creek Anticline owned by the company has been declining. About 25% of the oil is being recovered, leaving 75% of the oil in place. Horizontal drilling is being used to recover more oil, but is it extremely expensive. The past legislature overwhelmingly supported the tax incentives, and this has resulted in additional production.

Wes Welch, Vice President, Encore, said currently the company is the largest oil producer in Montana. When the Cedar Creek Anticline was taken over, it was producing about 12,500 barrels per day. Through their activities, they have increased production to nearly 14,000 barrels per day, which is due mostly to horizontal drilling. In 2001, they estimate spending \$40 million on capital improvements. This bill helps them look down the road and know there will be an incentive there. The benefits

from additional recovery include adding jobs, increasing revenues for the state and private land ownership, and has been a win-win situation for all parties concerned.

Patrick Montalban, Northern Montana Oil & Gas Association, said they do not have the money or capital to start secondary water flood projects, but it is important because they usually end up with these fields. It is a huge capital expense to convert these wells. In the Cut Bank field, there are 3000 wells, and they have only recovered 10% of the oil in place. If secondary recovery had not been done there, probably another 10-15% of oil would still be in place. The life was extended from the 1930's until now. This bill will help to continue the reserve life of the wells.

Steve Snezek, Governor's Office, said the administration's number one priority is economic development, and they feel this bill will help. This has already helped the oil and gas industry in Eastern Montana. This program works, and he urges we keep it.

Stan Kaleczyc, Burlington Resources Oil & Gas, said they supported the horizontal and secondary incentive program, and the company has these projects in southeastern Montana. This is an expensive form of operation, and it is estimated that it costs six times as much to remove the water and oil from a secondary project. Under this bill, recovering the oil reserves is beneficial to the state. It will continue a flow of revenues to the state and local governments.

Gloria Paladacek, Richland Economic Development, said profits are a good thing, and without the potential for profits, the oil is just going to remain in the ground. The county, state, oil companies, and royalty owners do not make money with the oil in the ground. These recovery projects need to continue.

Bob Fisher, President, Montana Petroleum Association, said his job as an explorationist is to find new reserves. 95% of the oil is usually left in the ground, but with secondary recoveries, a lot more oil can be taken out of the ground, which benefits everybody. The resources are there, but the capital costs determine whether it will be an economic venture.

Gail Abercrombie, Executive Director, Montana Petroleum Association, handed out some information. **EXHIBIT (tah36a01), EXHIBIT (tah36a02)**

Questions from Committee Members and Responses:

{Tape : 1; Side : A; Approx. Time Counter : 25.2}

REP. ESP asked how many dollars this incentive has saved per year. **Wes Welch** said he does not know. They are currently producing about 14,000 barrels per day, and 30% of that is from horizontal production, so it is probably about \$1 million. **REP. ESP** asked how much is paid in severance tax per year on the production now. **Wes Welch** said he does not have that answer. **REP. ESP** asked if this could be provided to the committee. **Wes Welch** said he could get these numbers.

REP. BALES asked what the life expectancy of a horizontal well is. **Wes Welch** said each site is different. In the Cedar Creek Anticline, they can have economic life expectancy for up to 12-16 years.

REP. WAITSCHIES asked if this bill covers all horizontal wells. **Wes Welch** said that is his understanding. **Jerome Anderson** said the bill covers re-entries and re-entries that relate to secondary recovery projects.

REP. ERICKSON asked if the same sort of tax breaks are received in North Dakota. **Wes Welch** said he is not as familiar with the tax laws in North Dakota. The basic severance tax laws in Montana are higher, but with the incentives he is not sure how they relate. **Jerome Anderson** said the effective tax rates for North Dakota and Montana are approximately the same. The effective tax rate in Montana in 2000 was 9.02% and North Dakota was 9.95%. **REP. ERICKSON** asked if there is information as to how many months a break is given for horizontal drilling in North Dakota. **Jerome Anderson** said it exempts new production of oil from a well that was previously shut down for two years for a period of 10 years. A horizontal well drilling is exempt for 24 months compared to 18 months in Montana. **REP. ERICKSON** requested the full set of data from North Dakota.

REP. BALYEAT asked if the governor has the continuation of this tax break in the budget. **Steve Snezek** said the fiscal note shows no difference in general fund or state special revenue in FY 2002. In FY 2003, it is a hit to the general fund of \$672 and state special revenue of \$108. **REP. BALYEAT** asked if there is a reason why it is so low. **Jerome Anderson** said this bill is revenue neutral because this is a tax incentive that is in place today. If the tax incentive is continued, it has no effect on the budget. Hopefully the levels of revenue increase because of more horizontal drilling put in place.

REP. ESP asked if there is an estimate of what this incentive has saved producers in Montana. **Gail Abercrombie** said currently the production tax rate on pre-1999 oil wells is 12.5%. The incentive for the secondary recovery is 8.5% and 5.3% for the tertiary. This lower tax rate is only on the incremental production above the decline curve. There is tax savings dependable on the value of the oil and the amount that comes. There are two variables of volume and price on how much would be saved. The production tax is on the gross value with nothing deducted. **REP. ESP** asked what dollar figure this tax incentive is worth to the industry. **Gail Abercrombie** said it depends on how much is produced and the value. Through the Department of Revenue, they can get the amount of oil reported in the secondary category.

REP. FORRESTER asked if Montana is getting the same price for crude as the West Texas intermediate. **Gail Abercrombie** said Montana crude gets \$3-5 less than West Texas intermediate because of transportation costs and quality, so Montana averages about \$22 per barrel.

REP. DALE asked for a follow up to Rep. Esp's line of questioning. **Patrick Montalban** said if the oil is not taken out of the ground, there is no tax dollars. If there is no secondary or tertiary water flood, the oil stays in place.

REP. STORY asked about stricken and then again added language in the bill. **SEN. McNUTT** said there was an amendment to address some confusion regarding secondary recovery not being new drilling.

Closing by Sponsor:

{Tape : 1; Side : B; Approx. Time Counter : 13}

SEN. McNUTT said when this bill was passed in 1993, the oil companies had liability that could be turned into assets by pumping more oil. The more oil brought out of the ground, the more tax that will be paid. This is a common sense approach to increasing production so the wells are not capped.

HEARING ON SB 133

Sponsor: SENATOR GREG JERGESON, SD 46, Chinook

Proponents: Cathy Muri, Department of Administration

Opponents: None.

Opening Statement by Sponsor:

{Tape : 1; Side : B; Approx. Time Counter : 14.7}

SEN. JERGESON said this is a housekeeping bill requested by the Department of Administration. It changes the names of several funds to conform to terminology according to GAAP. It does not change the function of any of the funds.

Proponents' Testimony:

{Tape : 1; Side : B; Approx. Time Counter : 18.9}

Cathy Muri, Administrator of Accounting & Management Support Division, Department of Administration, read her written testimony. **EXHIBIT(tah36a03)**

Questions from Committee Members and Responses:

{Tape : 1; Side : B; Approx. Time Counter : 22.6}

REP. STORY asked why the coal producers license tax is included in the bill, as the Supreme Court threw out the coal license tax and the redistribution of the money in the trust fund. **SEN. JERGESON** said for this bill they are just changing those names to relate to GAAP. It is not the purpose of this bill to clean up the statutes to conform to the Supreme Court ruling.

Closing by Sponsor:

{Tape : 1; Side : B; Approx. Time Counter : 25.4}

SEN. JERGESON said this is a bill that we need to pass.

EXECUTIVE ACTION ON SB 133

Motion/Vote: **REP. LASLOVICH** moved that **SB 133 BE CONCURRED IN.**
Motion carried 19-1 with Somerville voting no. REP. CYR will carry the bill.

EXECUTIVE ACTION ON HB 143

Motion: **REP. SOMERVILLE** moved that **HB 143 DO PASS.**

Discussion: **EXHIBIT(tah36a04)** **REP. SOMERVILLE** said this bill will revise and clean up some of the language in our pass-through

entities. There are 46 amendments to the bill.

EXHIBIT (tah36a05) They wanted to clean up the language regarding pass-through entities to eliminate some of the loop holes. **REP. STORY** said they want to try to track people who are members of limited liability and pass-through entities to make sure they are paying their taxes.

Motion: **REP. SOMERVILLE** moved that **AMENDMENTS DO PASS.**

Discussion: **Don Hoffman, Department of Revenue**, said this bill is the first step in clearing up the law in Montana with respect to pass-through entities who have out-of-state shareholders and partners. He explained the amendments in detail. **REP. BALLYEAT** said this is a major change with this bill. This is not the same as withholding it from employees' paychecks. In many cases, these partners and S-corporations never give paychecks to the partners or shareholders. The income that is reported on the tax return is many times not real dollars and really not any money there to pay the withholding that would be required. There could be a case where partnerships and S-corporations have to come up with money to pay this withholding. Even the people drafting this language say this is just a first step and they want to look at it for two more years, and they might have further changes in two years during the next session. There may be a loophole here, but he believes we should look at it for two more years and make sure they get it right the first time. **REP. SOMERVILLE** said there has been a tremendous increase in the use of limited liability partnerships and corporations in order to avoid paying taxes or pay a lower tax rate. The Department of Revenue is trying to clean up the language so we are collecting all of the funds for Montana that are due. It is the 2003 tax year that this becomes effective, and built into this is an education period that will start with the CPA's to make sure everyone is informed of what is required. **REP. CARNEY** said the withholding is the third step if they do not comply with the first two steps. She has investments that she does not get any money from, but she has to pay taxes on them anyway. Most of the people are wealthy and should not get a free ride when she has to pay taxes on hers. **REP. BALLYEAT** said he is not saying they should not have to pay the tax. The partnership or corporation does not owe the tax. By law they are just a pass-through entity, and the partner or shareholder is supposed to be paying the tax. He wonders if there are other avenues to still ensure partners and shareholders who are not residents of Montana pay their taxes without putting the responsibility on the business entities that may or may not have the money to pay. **REP. JACKSON** gave an example of a limited liability he is involved in and asked if with this bill there will have to be withholdings for Montana for this company in Colorado. **Don Hoffman** said he does not know Colorado law. Based

on information they have, Colorado does have a withholding provision. Colorado also allows for a deposit return like they are asking for. In order for this to have impact on the representative, that partnership would have to have activity in Montana, which it would not in that particular instance. If you do not elect as a partner or shareholder to do the composite return or consent order, then the withholding is applied as an estimated tax. There are 10 other states that do have some withholding requirement for these same type of entities. **REP. JACKSON** asked if he would have to pay penalty and interest if he waited until the end of the year to pay the tax. **Don Hoffman** said yes. **REP. BALES** gave an example of a mineral trust with owners in two states and asked how that would be handled under this bill. **Don Hoffman** said it would not impact trusts. **REP. BALYEAT** asked why is the agreement to file a tax return needed as stated in Section 6. **Don Hoffman** said it is a jurisdiction question. By them filing the consent agreement, they have acknowledge Montana now has jurisdiction. Otherwise, they are trying to collect the tax from someone where there is a question whether they have jurisdiction. **REP. BALYEAT** said there are people in Montana that our outside the jurisdiction, but that did not stop the state from assessing the tax and going after the collection and asked why it is different here. **Don Hoffman** said they are trying to deal with the non-residents, and they have a jurisdiction issue when it comes to these people and possibly getting a judgement against them. The consent establishes this jurisdiction. **REP. BALYEAT** asked if they have the authority to assess the tax anyway even if they do not file the consent. **Brenda Gilmer, Department of Revenue**, said there is a distinction with jurisdiction historically with the partnerships and corporations. With pass-through entities, there has not been a corresponding development with jurisdiction. The states have dealt with this issue by requiring a consent. **REP. FORRESTER** asked if the money on the fiscal note is included in the governor's budget. **REP. SOMERVILLE** said he did not know. He thinks it has to pass this committee before it would be included in the status sheets. **REP. FORRESTER** asked if this is considered a tax increase. **REP. SOMERVILLE** said for the people who are living out of state that have been avoiding paying Montana taxes, it probably is a tax increase. **REP. ERICKSON** asked how confident the sponsor is that the amount of money on the fiscal note will be collected. **REP. SOMERVILLE** said the \$1.3 million is an estimate of collection by creating a system to bring some people into compliance. **REP. ERICKSON** asked if there were figures that showed why \$1.3 million. **Don Hoffman** said the \$1.3 million in additional revenue is based on a project they did where partnerships and S-corporation returns filed in 1994-95 were reviewed. They pursued the filing of returns from non-resident

shareholders and partners. That project collected \$849,000, and based on the growth they have seen in these type of entities, they believe \$1.3 million can be collected. **REP. BALLEAT** asked what the increase was in S-corporations. **Don Hoffman** said there was a 62% increase in S-corporations between 1994 and 1999. **REP. BALLEAT** asked if that is based on national statistics. **Don Hoffman** said he would have to go back and check. He believes it was based on Montana. **REP. BALLEAT** said if it was national statistics, he would argue that the increase in Montana was not near as big. **Don Hoffman** said they have seen a significant increase in the number of S-corporations over the last 10 years.

Motion/Vote: **REP. SOMERVILLE** moved that **AMENDMENTS DO PASS**.
Motion carried unanimously.

Motion: **REP. SOMERVILLE** moved that **HB 143 DO PASS AS AMENDED**.

Motion: **REP. BALLEAT** moved that **AMENDMENT DO PASS**.
EXHIBIT (tah36a06)

Discussion: **REP. BALLEAT** said he wants to strike the section in the bill that deals with shutting down the ability for people to form a partnership or S-corporation strictly to make a charitable endowment contribution. Most of the bill is housekeeping and cleaning up language, but he sees this section as clearly dealing with the charitable endowment credit, and this is clearly a tax increase. This section is unnecessary in this bill. **REP. SOMERVILLE** said he opposes the amendment. When the charitable endowment credit was established, it was set up with the intent to allow individuals or corporations to do a charitable endowment to local community organizations, universities, schools, etc. The intent was not to create a rush into limited liability partnerships or corporations. **REP. BALLEAT** asked if this committee amends the charitable endowment by only allowing half of the contribution, this would eliminate the practice of forming LLC's and S-corporations simply to take the credit. **REP. SOMERVILLE** said he has a good point. He has never worked with anyone that has formed an LLC just to do a charitable contribution. They still might give it because they want a tax credit. **REP. BALLEAT** asked if the charitable endowment credit is amended so the credit given to S-corporations, partnerships, and LLC's is only half of the credit given individuals, would it be agreed that the practice of forming LLC's and S-corporations simply to get the credit would virtually disappear. **Don Hoffman** said he has not thought about that. **Brenda Gilmer** said the reason for forming LLC's and partnerships is not based on the amount of the credit, it is to avoid the requirement of making a planned gift. **REP. BALLEAT** said he has had clients who have

formed LLC's or corporations simply to make a charitable endowment gift so they did not have to do a planned gift, but he is convinced none of them would have done it if they had only gotten half of the credit given by making a planned gift at the individual level, because there are costs associated with forming an LLC or corporation. This section of the bill is unnecessary. **Jeff Martin** said the committee has already approved an amendment to this section dealing with the change in what an S-corporation is.

Motion/Vote: REP. BALLYEAT moved that AMENDMENT DO PASS. Motion failed 8-12 with Bales, Balyeat, Forrester, Fuchs, Jackson, Story, Waddill, and Waitschies voting aye.

Motion: REP. SOMERVILLE moved that HB 143 DO PASS AS AMENDED.

Discussion: REP. BALLYEAT said he is going to oppose this bill because it includes a tax increase. It is also putting increasing complexities onto businesses in Montana. There are other ways they could collect this tax. REP. DEVLIN said this bill focuses primarily on non-resident members of a pass-through entity. They will be notified they have to file a Montana income tax return. They are not being asked to do anything residents of Montana are being asked to do. REP. STORY said if there is any tax increase in this bill it has to do with the elimination of the credit for certain people. Going after people who are required to pay taxes is not a tax increases.

Motion/Vote: REP. SOMERVILLE moved that HB 143 DO PASS AS AMENDED. Motion carried 15-5 with Balyeat, Forrester, Fuchs, Jackson, and Wanzenried voting no.

EXECUTIVE ACTION ON HB 247

{Tape : 3; Side : A; Approx. Time Counter : 8.8}

Motion: REP. WANZENRIED moved that HB 247 DO PASS.

Discussion: REP. ERICKSON said this bill is clearly a fairness issue. The truckers made a decision a couple of years ago to keep it at a 6% rate. This is an impact on the general fund balance of \$661,000, which is less we can spend on education. REP. DALE said the trucking industry has a high level of taxes and fees beyond what normal businesses pay. There are many independents in this business who have to carry the burden of these costs. REP. WANZENRIED said one of the points made during the hearing is that this is a very mobile industry. There is a cost if we do this, but large companies will take their trucks to

other states. There will be a larger injustice done to the schools and local governments if these companies do locate elsewhere. **REP. BALES** said he has experienced difficulty trying to get trucks to haul feed into the state. As more trucks move out of state, it will be even harder to get trucks to haul into the state. **REP. SOMERVILLE** said trucking is a major industry in Montana, and we need to keep it here.

Motion/Vote: **REP. WANZENRIED** moved that **HB 247 DO PASS**. **Motion carried 19-1 with Erickson voting no.**

ADJOURNMENT

Adjournment: 10:33 A.M.

REP. BOB STORY, Chairman

RHONDA VAN METER, Secretary

BS/RV

EXHIBIT (tah36aad)